IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

NO. 75-668

AMERICAN INVESTMENT COMPANY, *et al., Petitioners*

v.

MYRON HARRIS, *Respondent*

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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OPINION BELOW

The opinion of the Court of Appeals is reported at 523 F.2d 220.

QUESTIONS PRESENTED

1. Should this Court grant certiorari to review a holding of the Court of Appeals, not in conflict with any decision of this Court or of any lower court, that damages under Section 10(b) and 18(a) of the Securities Exchange Act of 1934 are to be measured in accordance with accepted common law out-of-pocket rule as the difference between the amount paid by the plaintiff and the value of what the plaintiff received on the date of purchase or, alternatively, in the event the value as of the date of purchase cannot be ascertained because of the defendant's fraud, the proper date to be used is the date of the discovery of the fraud by the plaintiff or by the public?

2. In a case where the out-of-pocket damage rule applies, does a defrauded purchaser of stock owe a duty to the perpetrator of the fraud to sell the stock after discovering the fraud in order to mitigate damages?

ARGUMENT

1. Although the out-of-pocket rule, which is the proper method of measuring damages in a damage action under §10(b) of the Securities Exchange Act of 1934, measures damages as the difference between the amount paid and the value of the object purchased on the date of purchase, in cases where the defendant's fraud makes it impractical or impossible to determine the value on the date of purchase, the proper date to be used is the date the plaintiff or the public learned of the fraud.

The Court of Appeals reversed the grant of summary judgment for the simple reason that on the record before it, there was no support for the finding of the district court that the plaintiff had not suffered damages as a result of the defendants' alleged fraud.

The Court of Appeals quite correctly noted (App. 39), that the district court had not even considered the question of the proper measure of damages. Rather, the district court confused the question of the measure of damages with the question of causation—"plaintiff has not suffered any damages as a result of the alleged wrongdoing of the defendants. . . . ." (App. 9).

Before the issue of causation can be determined, damages must be defined. The Court of Appeals adopted the universally accepted out-of-pocket rule as being the difference between the amount paid and the value of the thing purchased. The next question is the proper date to be used in valuing the object purchased. In the normal case the date used is the date of purchase. The Petitioners acknowledge, at page 12 of their Petition, the propriety of the out-of-pocket rule which was not even considered by the district court.

The Court of Appeals pointed out that in many securities fraud cases, such as the instant case, because of the defendants' fraud, it is difficult, if not impossible, to prove the actual value of the stock as of the date of purchase.

Accordingly, the Court of Appeals suggested that the date of the plaintiff's discovery of the fraud or the date of the public's discovery of the fraud may be the proper date at which to ascertain damages. These alternate valuation dates have been used by various courts of appeals and are suggested by the Restatement of Torts 2d, §549, Comment (c) and the American Law Institute's Federal Securities Code draft.

Regardless of which date is chosen, there is no evidence in the record to establish the value of plaintiff's stock on the proper date. If the proper date is the date of purchase, assuming, as must be done on a motion for summary judgment, that as alleged in the complaint the defendants' fraud artificially inflated the plaintiff's purchase price, it is obvious that the plaintiff suffered damages. Likewise, the record is barren as to the identity of the date either the plaintiff or the public discovered the fraud. Certainly, there can be no evidence as to the value of the stock as of such date.

Notwithstanding Petitioners' protestations to the contrary (App. 11), the Court of Appeals did not write new law nor did it decide the case without the benefit of thorough briefing and oral argument. On the contrary, Respondent's brief in the Court of Appeals, which for the most part Petitioners chose to ignore, very elaborately developed the measure of damages argument.

The Petitioner's complain that no other court has held that the date of public discovery of the fraud is a proper date by which to measure damages. Notably, the Court of Appeals did not say that the public discovery of the fraud is the only date at which to ascertain damages but rather the Court said it *may* be the proper date—"The circumstances may disclose that only then did the market reflect the true value of the stock, unaffected by what is alleged to have been the defendants' continuing fraud: . . ." (App. 37).

The suggestion by the Court of Appeals of alternate dates to be used to ascertain damages in no way conflicts with the out-of-pocket rule followed by other courts cited

by Petitioners. Rather, the alternate dates are mere refinements of the ordinary rule. No other court has rejected the alternate dates. The Court of Appeals in this case found such alternate dates necessary since the determination of value as of the date of purchase may be impossible due to the defendants' fraud. As acknowledged by Petitioners, the Tenth Circuit has adopted the date of the plaintiff's discovery of the fraud as the appropriate date of measurement. See *Richardson v. MacArthur*, 451 F.2d 35, 43-44 (10th Cir. 1971); *Esplin v. Hirschi*, 402 F.2d 94, 104 (10th Cir. 1968) *cert. denied*, 394 U.S. 928 (1969).

The Tenth Circuit in adopting the date of the plaintiff's discovery of the fraud as the valuation date, recognized that it is not until the existence of the fraud is known that the true value of the securities can be ascertained. See *Esplin v. Hirschi, supra* at 104. The Court of Appeals in the instant case adopted that reasoning and concluded that logically the true value of the stock, unaffected by fraud, may actually not be ascertainable until the public at large discovers the fraud (App. 37). In the public securities market, true value would be reflected, not when an individual discovered the fraud, but only after the fraud was known to the public.

The decision of the Court of Appeals is not in conflict with any other Court of Appeals decision. The rule is logical and practical since it provides an equitable and realistic valuation procedure as an alternative to requiring the plaintiff to establish the actual value of the stock on the date of purchase when such is all be impossible due to the defendants' fraudulent conduct. The use of public discovery of the fraud as the date to compute damages is the most logical since the actual value of the securities is shown by "their market price after the public discovery of the fraud brings the price into accord with the actual value." Restatement of Torts, §549, Comment (c).

2. Under the out-of-pocket rule of damages, the plaintiff in a §10(b) action for damages is under no duty to sell his stock after the date of discovery of the fraud in order to mitigate damages.

The Court of Appeals rested its conclusion that the plaintiff had no obligation to mitigate his damages on two distinct bases. First, it found that under §10(b) it is inappropriate to impose on a defrauded plaintiff a duty to the defrauding defendants which duty requires the plaintiff to prematurely sell his stock.

Such a requirement would be grossly inconsistent with the remedial purposes of the Securities Exchange Act and Section 10(b), to which this Court has so clearly directed the attention of the federal courts. See *Superintendent of Insurance v. Bankers Life Company*, 404 U.S. 6 (1971); *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 521-22 (8th Cir. 1973).

Further, the Court of Appeals found the duty to mitigate inconsistent with the out-of-pocket rule of damages. The out-of-pocket rule sets a definite date as of which a plaintiff's damages are to be determined. Neither the acts of the defendant, nor the plaintiff, nor, for that matter the acts of third parties or the vagaries of the market place, enter into the determination of damages subsequent to the operative date. If the plaintiff chooses to retain his stock after that date, he cannot recover for subsequent declines in value nor can the defendants claim credit for subsequent increases in value. This result is an integral part of the out-of-pocket rule.

The duty to mitigate damages, finds its origins in actions on contract. To the extent that it has been applied in tort (fraud) and securities cases, it has been used solely to prevent a plaintiff from accumulating or increasing his loss after the damage has been established. This concept was developed by Judge Friendly in *Ellerman Lines, Limited v. The President Harding*, 288 F.2d 288, 289-90 (2d Cir. 1961) cited by Petitioners. The mitigation of dam-

ages question in that case was whether the defendant, whose ship had struck the plaintiff's ship, should be held liable not only for damages to the ship but for subsequent costs incurred by the plaintiff for pier and unloading charges which the defendant claimed were necessitated by the plaintiff's intervening negligence. The analogy to the instant case would be only to the issue as to whether the plaintiff would be entitled to damages for a decline in the value of the stock subsequent to the date set by the out-of-pocket rule. As pointed out above, the rule precludes the plaintiff from recovering such damages and accordingly the mitigation of damages concept has no application at all in this case.

Likewise, *George Cohen Sons & Company v. Koch*, 376 F.2d 629 (1st Cir. 1967), cited by Petitioners, discusses the duty to mitigate damages only in the context of a plaintiff's conduct in increasing his damages after the initial infliction of a tortious injury.

Foster v. Financial Technology, Inc., 517 F.2d 1068 (9th Cir. 1975), also cited by Petitioners, entirely supports the decision of the Court of Appeals herein. The Petitioners, somewhat disingenuously, chose to quote only a portion of the relevant discussion. The Court said at 1072. "As in all 10b-5 cases, their damages are limited by what they would have *realized if they had acted upon their claim when they first learned of the fraud or had reason to know of it.*" Citing *Epslin v. Hirschi, supra* (Emphasis supplied). Further, the portion quoted by the Petitioners (at page 9 of the Petition) ends with the clear statement that the chain of causation is broken when the plaintiff learns of the fraud — the plaintiff cannot recover for "further depreciation" after that date. In *Foster*, the plaintiffs were attempting to recover consequential damages in addition to the normal out-of-pocket damages. It is only in that context that the court there discussed mitigation of damage.

Lack Industries, Inc. v. Ralston Purina Co., 327 F.2d 266 (8th Cir. 1964), also stands for the proposition that a defendant is not responsible for damages beyond the chain

of causation. A plaintiff, after discovering fraud or misrepresentation, cannot stand by and "irresponsibly accumulate his losses to the detriment of his misrepresenter." *Id.* at 281. The out-of-pocket rule of damages by its operation necessarily precludes a plaintiff from so doing.

The operation of the out-of-pocket rule absolutely precludes a plaintiff from speculating at the defendant's risk, an evil which the Petitioners have attempted to introduce into this case by citing *Myzel v. Fields*, 386 F.2d 718, 740-41 (8th Cir. 1967), *cert. den.*, 390 U.S. 951 (1968). Under the out-of-pocket rule, the date to be used to measure damages (date of purchase, date of plaintiff's discovery of the fraud or date of the public's discovery of the fraud) will objectively be used to cut off damages. This leaves no room for "speculation" "spurious litigation" or other evils as suggested by the Petitioners.

Incomprehensibly, the Petitioners at page 10 of the Petition state that the case of *Cant v. A. G. Becker & Co.*, 379 F. Supp. 972 (N.D. Ill. 1974) relied upon by the Court of Appeals, did not directly consider the question of mitigation of damages. On the contrary, the Court of Appeals quoted directly (App. 40) from *Cant's* mitigation of damages discussion. The thrust of the Court's statement in *Cant* is that the date of discovery of the fraud is the proper date to determine damages; whatever happens thereafter cannot be used by the plaintiff or the defendant to alter the damages suffered. "This is the only method in which a consistent measure of damages can be obtained. If the defendant's contention was accepted the scale of damages would be prejudicially tipped in favor of the defendant." 379 F. Supp. at 975.

In summary, no court has imposed a duty on a defrauded plaintiff to mitigate damages by selling his stock in a rising market after discovery of the fraud. The courts which have dealt with the question have unanimously agreed that once the operative date is set as of which damages are to be determined, damages are fixed. Subsequent actions of the parties or the market cannot affect the plaintiff's damages.

CONCLUSION

Inasmuch as the decision of the Court of Appeals is correct on the merits, is consistent with the decisions of this Court as well as other federal courts and is not in conflict with the decision of any other Court of Appeals, Respondent respectfully requests that this Court deny the Petition for Writ of Certiorari.

Respectfully Submitted,

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